



Memorandum

*Regional Inspector General
Pretoria*

DATE: May 8, 2000

TO: Director, USAID/Kenya, Mr. Jonathan Conly

FROM: RIG/Pretoria, Joseph Farinella

SUBJECT: Audit of USAID/Kenya's Implementation of the Federal Managers' Financial Integrity Act, Report No. 4-615-00-007-P

This memorandum is our final report on the subject audit. The report contains two recommendations. We have considered your comments on the draft report and have included them in their entirety in Appendix II.

I appreciate the cooperation and courtesies extended to my staff during the audit.

Background

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) establishes requirements for management accountability and controls for federal agencies. This law encompasses program, operational, and administrative areas as well as accounting and financial management. Under the authority of the FMFIA, the Office of Management and Budget (OMB) issued Circular No. A-123 Management Accountability and Control, to provide detailed guidance for assigning federal managers the responsibility for designing management structures to help ensure accountability and include appropriate cost-effective controls.

OMB Circular No. A-123, states that management controls are the organization, policies and procedures used to reasonably ensure that: (1) programs achieve their intended results; (2) resources are used consistent with agency mission; (3) programs and resources are protected from waste, fraud, and mismanagement; (4) laws and regulations are followed; and (5) reliable and timely information is obtained, maintained, reported and used for decision making. The Circular provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on management controls.

In addition, the FMFIA required the U. S. General Accounting Office (GAO) to issue standards for internal control in the government. Control activities are the policies, procedures, techniques, and mechanisms that enforce management directives. Certain categories of control activities are common to all agencies and include, among other things, appropriate documentation, accurate and timely recording of transactions and events, and the proper execution of transaction and events.

Within USAID, the Agency issued Automated Directives System (ADS) Chapter 596, Management Accountability and Control, which provides the Agency's policy and procedures for establishing, assessing, correcting, and reporting on management controls under FMFIA and OMB Circular No. A-123. Additional guidance for assessing the adequacy of management controls and annual instructions for reporting the status of management controls is periodically provided by USAID's Bureau for Management, Office of Management, Planning and Innovation (M/MPI).

Audit Objectives

The Office of the Regional Inspector General, Pretoria (RIG/Pretoria), audited USAID/Kenya to answer the following audit objectives:

- **Has USAID/Kenya established management controls and periodically assessed these controls to identify deficiencies in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?**
- **Has USAID/Kenya reported material weaknesses in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?**
- **Has USAID/Kenya taken timely and effective action to correct identified management control deficiencies in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?**

Appendix I includes a discussion of the scope and methodology for this audit.

Audit Findings

Has USAID/Kenya established management controls and periodically assessed these controls to identify deficiencies in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?

USAID/Kenya has established management controls and periodically assessed these controls to identify deficiencies in accordance with the FMFIA and related regulations and guidance. However, we believe the Mission could further strengthen its management controls, and its review of those controls, by performing a formal and systematic risk assessment of its operations and programs. These areas are discussed below.

Management Controls Established and Assessed

FMFIA and OMB Circular No. A-123 provide guidance for use by Federal Agencies and managers to, among other things, establish management controls and to periodically assess the adequacy of those controls. Further, ADS Chapter 596, "Management Accountability and Control" instructs missions and cognizant managers to: (1) appoint a Management Control Official (MCO) to oversee and coordinate management accountability and control issues within the mission; (2) ensure that appropriate and cost-effective management controls are established; (3) continuously perform management control assessments in accordance with instructions issued by USAID's Bureau for Management's Office of Management Planning and Innovation (M/MPI); and (4) establish a Management Control Review Committee (MCRC) to assess and monitor deficiencies in management controls.

Moreover, M/MPI provides annual guidance to missions for conducting FMFIA reviews. In conducting reviews, missions are instructed to use existing sources of information to supplement management's judgment in assessing the adequacy of management controls, including: (1) management knowledge gained from daily operation of Agency programs and systems; (2) management reviews; (3) Office of Inspector General and General Accounting Office reports; and (4) program evaluations.

Missions are also instructed to review the Agency's ADS in determining mission compliance with policies and essential procedures. M/MPI provides a Management Control Checklist to assist in conducting the reviews. The Fiscal Year 1998 Checklist contained 163 control techniques extracted from the ADS.

In implementing the ADS, USAID/Kenya appointed the USAID/Kenya Acting Controller as the MCO to oversee and coordinate management accountability and control issues within the Mission. The Mission also established a MCRC comprised of office managers and headed by the Deputy Mission Director to provide oversight of its management control process.

USAID/Kenya took an organized approach in completing the Fiscal Year 1998 FMFIA assessment. The Controller's Office coordinated the review among the office managers or Strategic Objective Team Leaders (SO team leaders) and cognizant financial analysts, prepared a timetable for conducting the review and specified deadlines for the submission of the review results. A financial analyst within the Controller's Office formally transmitted the M/MPI checklist containing 163 control techniques along with instructions to cognizant offices within the Mission.

Upon receipt of the checklist, each office or SO team leader and cognizant staff determined whether the controls in their areas were satisfactory and noted any deficiencies. The teams then summarized their evaluation on a control technique worksheet and submitted it to a Controller Office's financial analyst assigned as the coordinator. After receiving this evaluation, the financial analyst reviewed and validated both the ratings of controls and the conclusions reached. These conclusions were subsequently reviewed by the Controller and

Mission's MCRC, who determined what actions should be taken on deficiencies and whether they should be considered material weaknesses. As required, USAID/Kenya reported its material weaknesses. The following table highlights the areas addressed by these control techniques.

CONTROL TECHNIQUES	
CATEGORY	NUMBER
Program Assistance	37
Organization Management	7
Administrative Management	40
Financial Management	44
Acquisition and Assistance	27
Audit Management Resolution Program	5
Other	3
TOTAL	163

Risk Assessments Would Further Strengthen the Mission's FMFIA Process

We found that USAID/Kenya has established the management controls outlined in USAID's ADS and, in some cases, has supplemented those controls. However, we believe formal and systematic risk assessment of its operations and programs, would strengthen the process.

GAO Standards for Internal Control in the Federal Government state that internal controls should provide for an assessment of the risks the agency faces from both external and internal sources.

Most of the Mission's assessments of management controls were conducted as a part of its Audits and Audits Resolution Program. Consequently, the mission's MCRC agenda focused on FMFIA issues, audit recommendation follow up, audits in progress, and planned audit management and resolution. While some of the USAID/Kenya SO teams conducted an ongoing monitoring program other SO teams within the Mission routinely performed management reviews by conducting site visits and field trips whose findings or results were documented. However in fiscal year (FY) 98, the mission primarily performed extensive management control assessments of its grantees and contractors, but did not systematically devote resources to assessing its internal controls of mission operations or in identifying areas that had high vulnerability to waste, mismanagement, fraud, abuse or misappropriation. For example in FY 98, USAID/Kenya's policies and procedures were included in its mission orders. Most of these orders date back as far as 1984 with no updates since that time. Moreover in 1998 the mission also issued 59 mission notices. Some of the notices addressed management controls that would be more appropriate to include in a

mission order, since mission notices are not normally used as a source of formal mission policies.

In another example, a management review disclosed that \$694,000 in non-expendable property (NXP) was unaccounted for in June 1997. By FY 98, the Mission was able to account for more than 80 percent of the loss after Offices of General Services and Financial Management compared the NXP list of losses to an “auction items sold” list. Although the mission indicated completed actions and events occurring between FY 92 – FY 97, the MCRC did not document any discussion of other high-risk functions or planned management assessments to determine the level of risk. As a result, mission operations susceptible to high risk have not been identified or assessed periodically to ensure that management controls mitigate the risks.

The benefits of risk assessment are two-fold. First, by conducting risk assessments, Mission managers can ensure that they have established management controls that are appropriate to their unique situation. Second, by identifying the level of risk in operations and programs, senior Mission management can focus more resources on high risk areas and less resources on low risk areas, thereby increasing its efficiency and effectiveness.

GAO recognizes the benefits of risk assessment and states that management needs to comprehensively identify risks and should consider all significant interactions between itself and other parties as well as internal factors within the entity and at the activity level.¹ Once risks have been identified, they should be analyzed for their possible effect, which includes estimating the risk’s significance, assessing the likelihood of its occurrence, and deciding what actions to take to manage the risk.

During our audit, we found that the Mission did not perform formal risk assessments in Fiscal Year 1998. Mission officials told us they believed that annual FMFIA assessment are designed to disclose major control vulnerabilities and highlight the need for more rigorous assessments. Although the mission managers told us they informally discussed vulnerable operations and processes, those discussions were not documented or recorded for follow-up. In addition they believed that guidance and training for field missions on conducting risk assessments should come from USAID/Washington

As in the case of the Mission’s inability to account for non-expendable property, USAID/Kenya established more stringent management controls after the vulnerability came to their attention. Although USAID/Kenya has established management controls and in some cases, supplemented those controls, we believe the Mission could further strengthen the efficiency and effectiveness of its reviews of the controls, by performing a formal and systematic risk assessment of its operations and programs. Therefore we are making the following recommendation:

Recommendation No. 1: We recommend that USAID/Kenya amend its Mission Orders to require regular risk assessments and reviews of internal mission controls.

¹ GAO’s Standards for Internal Control in the Federal Government, November 1999.

Has USAID/Kenya reported material weaknesses in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?

OMB A-123, ADS Chapter 596 and M/MPI's Fiscal Year 1998 instructions required missions to identify material weaknesses. USAID/Kenya did so identifying two material weaknesses; (1) Noncompliance of physical security of mission office building, and (2) the lack of computer system protection against viruses. The Mission reported those weaknesses in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance in October of 1998.

The Office of Management and Budget (OMB) Circular No. A-123 requires that a management control deficiency be reported if it is or should be of interest to the next level of management. This allows the chain of command structure to determine the relative importance of each deficiency. In this regard, USAID's ADS Chapter 596 and M/MPI's Fiscal Year 1998 instructions required Missions to provide a FMFIA certification to the cognizant Assistant Administrator with a copy to M/MPI, on the overall adequacy and effectiveness of management controls. This certification identifies any management control deficiencies determined to be material weaknesses, whether or not these deficiencies are correctable within the Mission's authority and resources.

The two material weaknesses reported by USAID/Kenya, physical security and computer virus protection, required operational expense funds (OE) to correct. Therefore, they were not correctable within the Mission's authority and resources. In the aftermath of the U. S. Embassy bombing in Nairobi in August 1998, OE money was used to pay for the increased physical security at the USAID offices and residences as well as to reconfigure the Mission offices to accommodate displaced embassy personnel. After this was accomplished additional OE funds were used to relocate the embassy personnel to more permanent offices while the temporary embassy was built. These actions not only required the use of the OE money but also disrupted and increased the normal work for Mission personnel. These costs put a great strain on the Mission's OE budget and the Mission personnel and resulted in the Mission not having OE money available to use to correct the management deficiencies. Both deficiencies were corrected during FY 99.

Has USAID/Kenya taken timely and effective action to correct identified management control deficiencies in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?

USAID/Kenya has taken effective action to correct deficiencies identified during its Fiscal Year 1998 review.² The Mission outlined its corrective action for deficiencies identified in its 1998 review in its MCRC meeting minutes and held periodic meetings to discuss the

² The Mission did not report any material weaknesses for FY 97, and therefore, did not have any to correct before its FY '98 FMFIA review.

corrective actions. However, the Mission's review and approval of the corrective actions could be improved.

OMB Circular No. A-123 and USAID's ADS Chapter 596 require Agency managers to take timely and effective action to correct deficiencies identified. USAID/Kenya took the appropriate action in correcting deficiencies identified in its Fiscal Year 1998 FMFIA review. The Mission closed the two deficiencies noted in FY 1998's FMFIA review. However, the Mission's MCRC files did not contain sufficient supporting documentation of the closure of these two material weaknesses.

The Mission relied on the MCRC to document the closure of its material weaknesses in its meeting minutes. However, the time lapse between the identification of a deficiency and the time the deficiency is closed may be several months. Therefore, the MCRC minutes recording of a deficiency identified in one fiscal year may not be documented as closed until later in the next year. For example, USAID/Kenya identified the two material weaknesses in FY 98; however, since a MCRC meeting was not conducted in the third quarter of FY 99, the closure of the two material weaknesses was documented in the fourth quarter minutes.

The lack of documentation when corrective actions are completed makes it difficult to determine if a corrective action was actually completed and whether the MCRC agreed to the closure of the material weakness. With a formalized tracking system by which to monitor the correction of an identified control deficiency, management would be better able to review as well as report on progress toward closure.

OMB Circular No. A-123 and USAID guidance state that management control assessments will be performed to identify deficiencies in Agency programs and operations and that corrective action plans will be developed to track the Agency's progress in resolving the identified deficiencies. Although USAID/Kenya identified management control weaknesses, the Mission did not develop a system to track corrective actions and identify when corrective actions were completed. This occurred because the Mission's system to record the correction of a deficiency was not being used consistently and documentation of the closure of the deficiency is not performed by using a formal closure memorandum describing the corrective action that was taken. As a result, the Mission may not have documentary support for the correction of identified management control deficiencies.

Although USAID/Kenya conducted MCRC meetings to discuss outstanding deficiencies, we believe that including closure memorandums on corrective action taken would be beneficial.

Recommendation No. 2: We recommend that USAID/Kenya amend its Mission Orders to require closure memorandums or a description of the actions taken to correct management control deficiencies that are identified.

Management Comments and Our Evaluation

In their written response to our draft audit report, USAID/Kenya management agreed with Recommendation Numbers 1 and 2. They also stated that actions have been taken to address those recommendations, which are summarized below.

With regard to Recommendation No. 1, management has drafted a Mission Order requiring periodic assessments and reviews of its internal controls on FMFIA evaluation and reporting. The first of these assessments will be made upon receipt of guidance from USAID/Washington. Similarly, with regard to Recommendation No. 2, management has included a provision in the above Mission Order requiring that formal closure memorandums be required for all actions taken to correct management deficiencies.

Based on the aforementioned actions, we believe that appropriate management decisions have been taken on the two recommendations. The Mission therefore needs to notify the Office of Management Planning and Innovation (M/MPI) in Washington when final actions are completed for the two recommendations

In addition, the Mission made some comments on our audit findings in the draft report which provide clarifications, explanation, and additional information with regard to those findings. Consequently, we have made appropriate revisions to the texts of those findings in this report, as deemed necessary. A complete text of the Mission's comments is included in Appendix II.

SCOPE AND METHODOLOGY

We audited USAID/Kenya's implementation of the Federal Manager's Financial Integrity Act (FMFIA). The audit was performed in accordance with generally accepted government auditing standards and was conducted from October 25 through November 19, 1999 at USAID/Kenya in Nairobi.


We reviewed the Mission's Fiscal Year 1998 FMFIA assessment and deficiencies noted in its Fiscal Year 1997 assessment. We did not design our audit to identify material weaknesses that were not reported by the Mission; however, if any previously unreported weaknesses came to our attention during the audit, we included these in our audit report.

The audit work included reviewing the Mission's system for establishing, assessing, reporting and correcting management controls. To accomplish the audit objectives, we reviewed the Federal Manager's Financial Integrity Act, Office of Management and Budget Circular No. A-123, General Accounting Office's "Standards for Internal Control in the Federal Government," and USAID's Automated Directives System (ADS) Chapter 596 on Management Accountability and Control. In addition, we reviewed the Agency's guidance for assessing the adequacy of management controls and annual instructions for reporting on the status of these controls, as well as other ADS Chapters relating to Agency policies and essential procedures, and recent Office of Inspector General audit reports performed at USAID/REDSO/ESA.

We developed and used a questionnaire to obtain information from the Mission's Management Control Official, Management Control Review Committee members and operating unit managers. To supplement this information, we also reviewed available documentation from Fiscal Years 1997 and 1998 FMFIA reviews, including management control deficiencies identified and management action plans for correcting those deficiencies. We reviewed the Mission's FMFIA Certifications to the AA/AFR on the overall adequacy and effectiveness of management controls, the material weaknesses identified, and obtained information on the status of the material weaknesses identified in the Fiscal Years 1997 and 1998 reviews.

MEMORANDUM

DATE: April 7, 2000

FROM: Lee Ann Ross, Acting Mission Director, USAID/Kenya 

TO: Joseph Farinella, RIG/Pretoria

SUBJECT: Audit of USAID/Kenya's Implementation of the Federal Managers' Financial Integrity Act, Report No. 4-615-00-XX-P

REF: Farinella/Conly Email Dated March 10, 2000

The following are our management decisions and comments regarding the findings and recommendations in subject draft report. Please feel free to contact us for more information or clarification.

1. Audit Objective #1

Recommendation No.1: We recommend that USAID/Kenya amend its Mission Order(s) to require regular risk assessments and reviews of internal mission controls (Draft Report page 4):

Management Decision: The Mission is in agreement with this recommendation and has included a provision in its draft audit/management controls Mission Order requiring periodic risk assessments and reviews of internal mission controls (see attached draft Mission Order, page 2, "FMFIA Evaluation and Reporting"). The first assessment will be initiated upon receipt of guidance from USAID/W.

Mission Comments on the Draft Finding: Paragraph 4 (Draft Report page 5) states that quote Mission officials told us they were not aware of the benefits of conducting risk assessments end quote.

The Mission requests that this section be reworded to reflect the fact that Mission officials believed that annual FMFIA assessment are designed to disclose major control vulnerabilities, and highlight the need for more rigorous assessments. Also, in this regard, FMFIA assessments for the last few years have yielded satisfactory results thereby eliminating the need for further assessment. In addition, it is the Mission's opinion that a recommendation requiring guidance and training for field missions on the conduct of risk assessments, needs to be directed at USAID/W.

2. Audit objective #2

Management Decision: Not applicable since there is no recommendation.

Mission Comments on the Draft Finding:

The last paragraph (Draft Report page 6) states that quote the two material weaknesses reported by USAID/Kenya, physical security and computer virus protection required

operational expense funds (OE) to correct. Therefore, they were not correctable within the Mission's authority and resources. ----- and resulted in the Mission not having OE money available to use to correct the management deficiencies end quote.

The Mission would like to make the following comments:

- The statement that these two weaknesses were not corrected contradicts the first paragraph of Audit Objective #3 which states that quote USAID/Kenya has taken effective action to correct deficiencies identified during its Fiscal Year 1998 review end quote
- Both material weaknesses were corrected in FY99 as follows: (a) Physical security, when the Mission moved to a location that meets Agency security standards, and (b) computer security, in the third quarter of FY99 when the installation of Agency-approved anti-virus software in all its servers and PCs was completed.
- The statement that the weaknesses were not correctable within the Mission's authority and resources was only applicable to physical security.

3. Audit Objective #3

Recommendation No. 2: We recommend that USAID/Kenya amend its Mission Order(s) to require closure memorandums or a description of the actions taken to correct management control deficiencies that are identified (Draft Report page 7).

Management Decision: The Mission is in agreement with this recommendation and has included a provision in its draft audit/management controls Mission Order requiring formal closure memorandums for all future closure actions (see attached draft Mission Order, page 2, "FMFIA Evaluation and Reporting").

Mission Comments on the Draft Finding:

- The statement in the second paragraph of this finding (Draft Report page 6) that quote the Mission closed the two deficiencies in its Fiscal Year 1997 FMFIA review end quote, contradicts Footnote 2 which states that the Mission did not report any material weaknesses for FY97.
- The Mission requests that the first and last paragraphs of Draft Report page 7 be reworded to reflect the fact that the Mission, consistently and in timely manner, uses quarterly MCRC minutes to document the approval, implementation and completion of FMFIA closure actions. The following is pertinent in this regard:
 - MCRC meetings are held every quarter (unless for documented reasons, it is decided that a meeting is not necessary), and the minutes copied to all members in a timely manner.
 - The status of the two FY98 material weaknesses was consistently discussed in every meeting until closure actions were completed at the end of FY99.

- The physical security weakness was not closed until the Mission relocated at the end of the fourth. Therefore, the statement (first paragraph) that closure was reported in an email during the third quarter is incorrect. The email provided a status update while the fourth quarter MCRC minutes documented closure.